No. 12206

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

GEORGE T. GOGGIN, Receiver of the Estate of Salsbury Motors, Inc.,

Appellant,

vs.

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Appellee.

REPLY TO APPELLANT'S PETITION FOR REHEARING.

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Pursuant to the order of this Honorable Court withdrawing its opinion heretofore filed and granting appellant's petition for further consideration of the cause, appellee respectfully submits its reply to the legal points made in Appellant's Petition for Rehearing.

Appellee respectfully suggests that this Honorable Court's affirmance of the order of the Referee and the judgment of the District Court was correct upon the grounds stated in the Court's opinion and upon other grounds stated in the briefs. As the Court has indicated a desire to consider the matter further, appellee is appreciative of the opportunity of a reply to the appellant's arguments in the Petition for Rehearing.

Any point of law predicated upon the common law and particularly the law merchant has become a difficult one. Lawyers and even the courts have become used to statutory law. When so many of the early principles of the common law have been embodied into codes in most jurisdictions, the ability to rely upon the statutory provisions and decisions of the courts under them in most situations has put lawyers and courts alike out of practice in ferreting out and distinguishing the technicalities and niceties of the decisions of the courts of a hundred or a hundred and fifty years ago.

It is not altogether surprising, therefore, that in a case such as this the briefs of both parties, taken together, have failed to present the matter to this Court in a manner sufficient to enable the Court to weigh the issues and decide them with conviction. It will be our aim in this brief to present as clearly and as fairly as may be done what we consider the correct legal principles applicable to the facts of the case.

Appellant's Petition for Rehearing urged two grounds:

First: That this Court's conclusion was based upon an implied finding which was contrary to the evidence in the case, to the express stipulation of the parties and to the findings of the Referee.

Second: That the Court's former opinion extends the banker's lien beyond its rightful scope without legal or equitable justification, and that this phase of the opinion is particularly harmful in bankruptcy proceedings because it permits banks to obtain a secret lien and a preference.

We will answer the legal points made in appellant's brief in support of these grounds.

POINT I.

The Stipulated Facts Justify the Conclusion That Credit Was Granted Upon the Expectation and Implied Agreement That Collection Items Would Be Deposited With the Bank.

The gravamen of appellant's first ground appears to be that the Court made an implied finding that credit was extended by the Bank upon the faith of the debtor's notes and drafts and that this implied finding is contrary to the evidence, and the petition asserts that this Court was unwarranted in making such a finding which was contrary to the findings of the court below.

The opinion of this Court pointed out the existence of a stipulated fact, namely, that there was an agreement made between the Bank and the debtor, upon the extension of credit by the Bank, that collection items of the debtor would be handled through the collection department of the Bank. From this stipulated fact this Court determined that as a matter of law the credit extended by the Bank to the debtor was made upon the faith that the notes and drafts and collection items would be deposited with the collection department of the Bank in all future transactions, and that this expectation and agreement was sufficient to satisfy any requirement that in order that a banker's lien attach to securities in the hands of a bank there must be an extension of credit upon those items.

Although the petition urges that this Court cannot find an implied agreement that the debtor would place its commercial paper with the Bank (Pet. p. 2), such an agreement is admitted for the purposes of argument on the petition for rehearing (Pet. p. 17). The existence of such an agreement is clearly demonstrated by the record

and was properly considered by this Court even though it was not included in the findings of the Referee.

The statement made at the hearing before the Referee [R. 104] was clear and unequivocal. It stated that there was an implied understanding between the Bank and the debtor that all usual banking transactions would be handled through the Bank and further that "the implied understanding included that as to collections or notes or sight drafts or bills of lading that they would be handled through the collection department of the Bank of America."

It is true, of course, that the stipulation of facts was stated to be only for the purpose of the pending proceeding to determine summary jurisdiction of the Referee. It was nevertheless a stipulated fact made with the intention that the Court should rely upon it, and it is part of the record on appeal at the request of appellant himself.

It was urged in the Receiver's specifications of objections to findings of fact, conclusions of law, and order allowing claim that reference should be made to the oral stipulation in the Jacques Power Saw matter [R. 101]. It was asserted in the petition for review [R. 93] that the order was erroneous because "the findings of fact fail to include the evidence introduced before this Court by oral stipulation in the hearings on the Jacques Power Saw Company matter, held before this Court on December 2, 1947."

The implied agreement contained in the oral stipulation was not cancelled or superseded by the subsequent written stipulation of facts appearing at pages 70-71 of the Record. Nor is the subsequent stipulation of facts inconsistent with the oral stipulation made at the hearing on December 2, 1947. On the contrary, the facts stated

in the written stipulation [R. 70-71] establish a rather compelling inference that the general credit under the loan agreement was extended upon the implied understanding that the general course of dealing would be embarked upon and would continue, and of course the facts show that it did.

The existence of the agreement that collection items would be handled through the Bank as part of a general course of dealing agreed upon at the time of the extension of credit is not inconsistent with any finding of the Referee. The memorandum opinion of the Referee [R. 79] indicates that the evidence showed that it was the practice of the debtor to place sight drafts and other commercial paper with the Bank for collection and that the proceeds would be credited to the account of the debtor when collected. The Referee's findings [R. 83] show, in accordance with the stipulation of facts, that in the *regular course of business* drafts were deposited for collection and were collected and deposited to the debtor's account. The findings and the stipulation of facts also show [R. 89] that in each of the collection items in the hands of appellee at the time of filing the petition there were specific instructions to collect the items and to credit the proceeds when received to the commercial account of the debtor.

The Receiver argues that the original trier of the facts scrupulously, carefully and consistently avoided any finding to the effect that credit had been extended upon the faith of the notes and drafts involved in this proceeding (Pet. for Rehearing, pp. 6-7). This contention is not borne out by the record. In his specification of objections to the findings of fact, conclusions of law and order allowing claim [R. 101] the Receiver specifically requested that

there should be added to Finding VIII [R. 89] the following language:

> "However, no credit had been extended in reliance upon said collection items, and no part thereof had been collected on August 20, 1947, when the Receiver demanded the return of the collection items."

While it appears that these objections and the request for the specific finding may not have been received by the Referee until after the findings had been signed [see letter 4-16-48, R. 100], they were specifically made a part of the petition for review [R. 93, 99, Item 15] and were apparently considered and expressly overruled by the District Court [R. 110]. It is apparent from this that counsel's assertion that the trier of the facts scrupulously avoided a finding that credit had been extended upon the faith of the notes and drafts is not correct. The Record would more nearly indicate that the Referee and certainly the District Court declined to make the finding requested by counsel, which, it is asserted, is the very basis of the Receiver's case.

In any event, there is no legal or equitable reason why under these circumstances the fact of the existence of the agreement which is actually in the record before this Court should not be taken into consideration by the Court in its decision in the case. The rule is that where there is no conflict in the testimony the Appellate Court has the power and the duty to review the evidence and form its independent judgment upon the sufficiency thereof.

> *Carr v. Southern Pacific Co.* (C. C. A. 9, 1942), 128 F. 2d 764, 768;
>
> *Security Building and Loan Assn. v. Spurlock* (C. C. A. 9, 1933), 65 F. 2d 768, 770.

The rule is well established that where the facts are admitted or otherwise undisputed, the Court of Appeals may make its own judgment without dependence upon the findings of the trial court (see *Sheldon v. Waters*, 168 F. 2d 483 (C. C. A. 5, 1948); *Stewart v. Ganey*, 116 F. 2d 1010 (C. C. A. 5, 1941); *In re Chicago and North West Railway Co.*, 110 F. 2d 425 (C. C. A. 7, 1940); *United States v. Anderson*, 108 F. 2d 475 (C. C. A. 7, 1939) (findings based on documentary evidence and stipulations); *Quinn v. Union National Bank*, 32 F. 2d 762 (C. C. A. 8, 1929); *Elbro Knitting Mills v. Schwartz*, 30 F. 2d 10 (C. C. A. 6, 1929) (findings based on stipulations and undisputed evidence); *Walton v Atha*, 262 Fed. 75 (C. C. A. 3, 1919).

This Court's conclusion that the general course of dealing between the bank and the debtor and the expectation that collection items would be deposited with the bank pursuant to the implied agreement was the equivalent of present consideration, if any was required to establish a banker's lien, is amply supported by the authorities. We propose to discuss the cases in detail at a later point in this brief, and that discussion will show that the language quoted here is pertinent to the facts of the particular case. In order to clarify and to conclude the discussion of this point, we quote from some of the decisions upon this point.

> *Bank of the Metropolis v. New England Bank*, 1 How. (42 U. S.) 234-239, 11 L. Ed. 115 (1843).
>
> "We do not perceive any difference in principle between an advance of money and a balance suffered to remain upon the faith of these mutual dealings. In the one case as well as the other, credit is given upon the paper deposited or *expected to be trans-*

mitted in the usual course of the transactions between the parties."[1]

In *Russell v. Haddock,* 8 Ill. (3 Gil.) 237, 242 (1846), referred to in the former opinion of this Court for the proposition that there must be a credit upon securities in possession or expectancy, the Court said:

> "If they placed funds in the hands of Smith & Co. in either of these modes it was upon the faith of the securities already on hand *with the expectation that they would continue to remit paper for collection as formerly* * * *."

In *Citizens Bank and Trust Co. v. Yantis* (Tex. Civ. App.), 287 S. W. 505, 508 (1926), the Court said:

> "Credit is given upon the faith of the mutual dealings and upon the contemplation of paper deposited or *expected to be delivered in the usual course of the transactions* between the parties. So, if the balances are allowed to stand uncollected and the debt allowed to be constantly renewed and extended, by express agreement, the law will apply the same rule to the rights of the parties as though there had been an express agreement, and such mutual indulgences on such balances would create a valid consideration and give the bank the right to retain and apply the balance due on closing the account."

The record in the present case shows not only a general course of dealing in which collection items were deposited for collection and credit to the debtor's account, but it also shows that loans were allowed to stand uncollected and that the indebtedness of the borrower was renewed and extended. The stipulation of facts shows that fol-

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[1]Throughout this brief, emphasis added unless otherwise noted.

lowing the original loan agreement on February 18, 1946, the agreement was amended to provide for an additional *revolving credit* of not to exceed $450,000 for the period of one year [R. 82].

In *Gibbons v. Hecox*, 105 Mich. 509, 63 N. W. 519 (1895), the Court said:

> "The reason given for allowing the lien is that any credit which a bank gives by discounting notes or allowing an overdraft to be made is given on the faith that *money or securities* sufficient to pay the debt *will come into the possession of the bank in the due course of future transactions.*"

In *Greene v. Jackson Bank,* 18 R. I. 779, 30 Atl. 963 (1895), where notes were left with a bank for collection, the Court said the bank had a lien, "the presumption being that its advances to him were made on the credit of such securities."

In *Central National Bank v. Connecticut Mutual Life Insurance Co.* (sometimes cited *National Bank v. Insurance Co.*), 104 U. S. 54, 71, 26 L. Ed. 693, 701 (1881), a case also referred to in this Court's prior opinion, the Court made the statement that the lien attaches upon securities deposited in the usual course of business "for advances which are supposed to be made upon their credit." This language varies somewhat from that found in the other cases, but in the light of the decisions it is clear that the expression "supposed to be made upon their credit" should be read as "presumed to be made upon their credit."

Appellant has argued that the bank has never seriously contended that credit was extended upon the faith of the notes and drafts which had been deposited with the bank

for collection. It has not, of course, ever been suggested that immediate credit was given to the debtor upon the deposit of these items for collection and credit to the account. The stipulated facts show that the proceeds of the items were not credited to the account until they were actually collected. The point was made by appellee, however, that where there is a general course of dealing such as existed in this case, there is a presumption implied by law that the credit outstanding was extended in the first instance or suffered to remain unpaid upon the basis of the general course of dealing. The cases that have been referred to above amply demonstrate this principle.

In conclusion upon this point, it is therefore respectfully submitted that from the stipulated facts in the case there was an implied agreement that as part of the consideration for the extension of credit by the bank to the debtor a general course of dealing was contemplated and that the bank and the debtor both expected that this relationship would continue and that the debtor would deposit collection items with the bank for collection and credit to his account. If any consideration was required to establish the banker's lien under such circumstances, it is to be presumed as a matter of law from the conduct of the parties. There has been no evidence to rebut that presumption or to indicate that the parties intended something different. We therefore submit that this Court's conclusion upon this point in its prior decision was correct and amply supported by the authorities.

POINT II.

An Affirmance of the Judgment of the Court Below Will Not Extend the Banker's Lien but Will Apply Principles of the Law Merchant Which Have Been in Effect for Over 150 Years.

The second point urged by appellant in his petition for a rehearing is that the Court's former opinion extends the banker's lien beyond its rightful scope without legal or equitable justification.

The argument in support of this point may be briefly summarized somewhat as follows: The function of the banker's lien has not been broadened by statute; the cases referred to by appellant show there was no banker's lien because no credit was advanced; an agreement by a borrowing customer to use other services of a bank would include escrow, safe deposit and safekeeping services and the banker's lien was never used for this purpose; and the decision creates a new type of secret lien contrary to the intention of the Bankruptcy Act and therefore even if there were an agreement for a general course of dealing between the bank and the debtor there should be no banker's lien upon the collection items. If the bank did not discount the notes and drafts or accept them as a direct pledge, it is asserted that it could not be considered that the bank intended to rely upon them.

The assertions contained in the petition for rehearing extend far beyond those made in the appellant's briefs. The argument has been reduced to the direct statement that the banker's lien is limited to advances actually made upon the credit of the particular property involved. (Pet. p. 11.) This contention is the crux of the whole of appellant's case. *It is not supported by the authorities.* On the contrary, the true rule is that the banker's lien

attaches upon any property that comes into the hands of the bank in the course of its business as a banker to secure any past due indebtedness of the customer.

The basic principle of the law merchant establishing the banker's lien has always been subject to limitations expressed in the statement of the rule itself. Appellant has attempted to appropriate language of the Courts used in applying and interpreting such limitations to the facts of the present case in which they are clearly not applicable. This lack of understanding of the basic principle and its limitations has led to a misinterpretation of the decisions and to conclusions that are entirely unwarranted under the law.

(a) The Basic Doctrine of the Banker's Lien.

There is no clearer statement of the doctrine of the banker's lien than that contained in Section 3054 of the Civil Code of the State of California. It is evident that every word and every phrase of that section was carefully considered and that it embodies fully and completely the principle known to the law merchant with the limitations expressed in the decisions.

Appellant has argued that to understand the meaning of the language used in this section it is necessary to analyze and consider the cases referred to by the Code Commissioners of the State of California in drafting the section because our courts have held that codification of the rule has not extended its scope. Let us accept that premise.

The note of the Code Commissioners cited five cases.[2] From the manner in which the section is annotated, it would appear that the Commissioners referred to the case of *Davis v. Bowsher,* 5 T. R. 488, 101 English Reports 275, as *authority* for the basic principle embodied in the code section and referred to the other cases, not as authority for the principle, but by way of *explanation* of it. There is clearly a distinction between the citation of the first case followed by the statement "see Brandao v. Barnett, * * *" etc.

Davis v. Bowsher, supra, is not only the primary basis for Civil Code Section 3054, it is almost universally cited in the textbooks and decisions as authority for the banker's lien and as a statement of this basic principle of the law merchant. In view of the importance of this case let us consider it carefully.

Appellant correctly quotes the headnote as follows (App. Op. Br. p. 26):

> "A customer lodges bills of exchange in the hands of his banker generally, and when the banker advances money to him, he applies it to the discount of such bills as happen to be nearest in value to the sum advanced, but without any special agreement to that effect. This does not invalidate the banker's general lien upon all the other bills in his hands, but he may retain them in order to secure the payment of his general balance."

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[2]"Note—*Davis v. Bowsher,* 5 T. R., p. 488; see *Brandao v. Barnett,* 3 C. B., p. 519; rev'g S. C., 6 M. & G., p. 630, and affirming S. C., 1 M. & G., p. 908; *Bank of Metropolis v. New England Bank,* 1 How. U. S., p. 234, 6 *Id.* p. 212; *Van Amee v. Bank of Troy,* 8 Barb., p. 312; 5 How. Pr., p. 161; *McBride v. Farmers' Bank,* 25 Barb., p. 657; 26 N. Y., p. 450." (2 Civil Code of the State of California (1872), p. 315.)

The headnote is not sufficient to show the real facts and legal issues determined. The action was brought by the bankers upon a single bill of exchange which, with others, had been lodged in the hands of the bankers. *No credit had been advanced upon this bill*, nor upon some other bills lodged with the bankers. Previously other bills had been discounted and there was a general account due to the bankers. When an advance subsequently requested by the payee upon this bill was refused by the bank, the payee demanded a return of all the items not discounted, which the bank refused, alleging the right to retain all the bills. Subsequently the bank brought an action in assumpsit to recover from the drawer of the bill. Judgment for the plaintiff was affirmed on appeal.

It should be noted that the bill upon which suit was brought was one upon which *no credit had been advanced* when lodged with the bankers, although there was a general balance due to the bankers from prior transactions.

Lord Kenyon, Chief Justice, states the principles of the banker's lien as follows:

> "I am clearly of the opinion that by the general law of the land a banker has a general lien upon all the securities in his hands belonging to any particular person for his general balance, unless there be evidence to show that he received any particular security under special circumstances, which would take it out of the common rule. But it is taken for granted by the counsel in support of the rule, that the party had a right to demand of the bankers certain bills, which were not discounted, without paying their general balance; and the whole argument is built on that mistake. I think he had only a right to demand this bill *sub modo*, namely, on paying all that was

due to the bankers: *for wherever a banker has advanced money to another, he has a lien on all the paper securities which come into his hands for the amount of his general balance.* . . . It is very proper that there should be a known rule to govern the conduct of all persons of this description, whose dealings are very extensive; and that rule is, that no person can take any paper securities out of the hands of his banker, without paying him his general balance, unless such securities were delivered under a particular agreement, which enables him to do so."

This is the basic principle of the banker's lien as known to the law merchant. The bank has a lien on all property in its hands for the general balance due from a customer. There is no requirement here, nor in the Code section, that credit be advanced upon the particular item in order that the lien attach. No credit had been extended upon deposit of the item. The language of Chief Justice Kenyon is too clear to admit of doubt. He said *wherever* a banker has advanced credit to another, he has a lien on all the paper securities *which come* into his hands. In that case as in the instant case, the indebtedness was in existence at the time the paper came into the hands of the bank. No credit was extended upon receipt of the paper (although it was upon collection), but there as here the lien attached when the paper *came into the hands of the bank.*

Appellant's description of this case is that the Court held that the bank was entitled to hold the bills to protect itself since credit had been extended upon the whole account; that certain bills had been discounted merely for convenience, not for the purpose of signifying reliance upon them alone; and that manifestly the credit was extended upon the entire account. (App. Op. Br. p. 26,

Note 9.) We find nothing in the decision to warrant such conclusions. The indebtedness had been created *before* the bill in question had been lodged with the bank

The principle established by *Davis v. Bowsher,* namely, that a banker is entitled to a banker's lien upon collection items delivered to the bank without the extension of any credit upon them, has been consistently followed up to the present time. To demonstrate that this is true, we will refer the Court to some of the cases passing directly upon this point, in addition to the authorities cited in our previous brief.

Gibbons v. Hecox, 105 Mich. 509, 63 N. W. 519 (1895), was an action by the Receiver of the City National Bank of Greenville to establish a lien upon a promissory note for $1,000 which was in the possession of the bank at the time of its failure. The facts showed that one Charles L. Hecox was indebted to the bank upon a promissory note for $2,000, and that prior to the maturity of his indebtedness he deposited with the bank for collection a promissory note for $1,000 signed by Sprague. After the failure of the bank and after the maturity of Hecox' note to the bank, Hecox assigned the Sprague note to Phelps. The action was dismissed upon demurrer in the Court below and reversed upon appeal. The Court said:

> "The general rule derived from the cases is that the bank has a lien on all money, notes, and funds of a customer in its possession, for any indebtedness of a customer to the bank which is due and unpaid. The reason given for allowing the lien is that any credit which a bank gives by discounting notes or allowing an overdraft to be made is given on the faith that money or securities sufficient to pay the debt *will come into the possession of the bank in the*

due course of future transactions. In Re Farnsworth, 5 Biss. 223, Fed. Cas. No. 4,673, Judge Blodgett, of the United States circuit court of Illinois, held that a bank holding a customer's demand note has a lien upon the proceeds of drafts delivered to it for collection after the giving of the note, though collected after the filing of petition in bankruptcy, and can apply such proceeds upon the note."

Greene v. Jackson Bank et al., 18 R. I. 779, 30 Atl. 963 (1895), was an action by an assignee for the benefit of creditors to recover from the defendant bank the proceeds of a promissory note left with the bank for collection by the insolvent prior to the assignment. The Court said:

> "The case shows that these notes on which the dividend accrued had been left, prior to the assignment, with the bank for collection in the usual course of business. This being so, the bank, according to the authorities, was entitled to a lien on Warner's half of the notes for the payment of any balance on general account which it might have against Warner, *the presumption being that its advances to him were made on the credit of such securities.* 1 Morse, Banks (3d Ed.) Sec. 324; Lehman v. Manufacturing Co., 64 Ala. 567, 595; Central Nat. Bank v. Connecticut Mut. Life Ins. Co., 104 U. S. 54, 71; *Ex parte* Pease, 1 Rose, 232; *Ex parte* Wakefield Bank, Id. 243, 19 Ves. 25."

It should be noted again that in this case there was no evidence of any consideration advanced to the insolvent upon the deposit of the promissory note with the bank for collection. On the contrary, the Court said that there was a presumption that the advances made to the insolvent by the bank were made on the credit of such securities.

In *Cockrill v. Joyce* (1896), 62 Ark. 216, 35 S. W. 221, McCarthy & Joyce Co. was indebted to the First National Bank for $101,000. It deposited certain notes with the bank either for collection or as additional security. In an action to recover the notes by the assignee of McCarthy & Joyce, the trial court found that the notes had been deposited for collection and not as collateral security and gave judgment for the plaintiff. This judgment was reversed on appeal. The Court said:

> "Under these circumstances, we conclude that the bank had a lien upon the notes for the payment of the amount due it by the company, without regard to the fact whether there was an express agreement for a lien or not. The law on this subject is well settled, and is thus stated by a recent writer: 'A banker has a lien on all securities of his debtor in his hands for the general balance of his account, unless such a lien is inconsistent with the actual or presumed intention of the parties. The lien attaches to notes and bills and other business paper which the customer has intrusted to the bank for collection, as well as to his general deposit account . . . *And so, if the securities be deposited after the credit was given, the banker has a lien for his general balance of account, unless there be an express contract, or circumstances that show an implied contract, inconsistent with such lien.*' 1 Jones, Liens (2d Ed.), Sec. 244."

Here again the Court held the lien existed when the notes were deposited for collection and no credit was extended upon them, the indebtedness existing being a pre-existing debt.

There was a sequel to this litigation in the case of *Joyce v. Auten*, 179 U. S. 591, 45 L. Ed. 332 (1900). The

assignee of McCarthy & Joyce had sold the assets of the insolvent, including the notes in the possession of the First National Bank. The purchaser signed notes for the purchase price, with a surety. Upon failure to pay, the assignee sued the surety, which endeavored to defend upon the ground, among others, that the notes retained by the First National Bank were more than sufficient to pay the balance due and the assignee should collect from the bank. This was in effect again raising an issue as to the validity of the banker's lien on the notes. A demurrer to this defense was sustained. In affirming the judgment the Supreme Court of the United States said:

> "The second defense is substantially that the bank was a creditor of the insolvent firm; that it was a preferred creditor; that it had certain notes for collection; that those notes were included in the sale, but were not turned over to the purchaser, and that they were of sufficient value to offset the amount due on this note. It is not alleged that the debt due from the insolvent to the bank had been paid by collection of those notes or otherwise, but the defense is rested on the averment that notes thus deposited and unpaid were of sufficient value to pay the unpaid purchase money. It is familiar law that a bank receiving notes for collection is entitled, in the absence of a contract, expressed or implied, to the contrary, to retain them as security for the debt of the party depositing the notes. 1 Jones, Liens, 2d ed. Sec. 244; *Bank of the Metropolis v. New England Bank,* 1 How. 234, 239, 11 L. Ed. 115, 116; *Reynes v. Dumont,* 130 U. S. 354, 391, 392, 32 L. Ed. 934, 944, 9 Sup. Ct. Rep. 486. But if such a banker's lien existed the sale transferred nothing but the equity in those notes after the payment of the debt secured by their deposit."

The Supreme Court reached the same conclusion as to the validity of the banker's lien upon commercial paper deposited for collection as that made in *Cockrill v. Joyce, supra.*

In 1917 the Supreme Court of Vermont decided the case of *Goodwin v. Barre Savings Bank and Trust Co.*, 91 Vt. 228, 100 Atl. 34. This was an action by a trustee in bankruptcy to recover from the defendant bank the proceeds of certain contracts which had been left with the bank by the bankrupt for collection. *No credit was extended upon deposit of the items.* The facts therefore are parallel to the present case, that is, the trustee in bankruptcy was asserting that the bank had no right to a banker's lien upon paper in its possession for collection at the time of bankruptcy.

The plaintiff contended that three contracts which had been placed with the bank for collection were placed in the bank's hands for collection only and that therefore the bank was not entitled to assert a banker's lien. The bank asserted its right to hold the contracts under a banker's lien and also upon the contention that they had been orally assigned as additional security. The verdict of the jury was for the plaintiff and the bank appealed.

The trial court had charged the jury that if the contracts in question were delivered to the defendant for collection merely, the plaintiff was entitled to recover, and an exception was taken to this instruction. The Court on appeal sustained this exception and reversed the judgment of the court below upon the ground that when paper securities are deposited with a banker as security or for collection, *nothing more appearing,* they are subject to

the banker's lien for the general balance due to the bank, and in this connection the Court said:

> "We think the contracts in question are 'paper securities' within the meaning of the rule. The theory of the law is that a bank extends credit and accommodations to its customer in reliance upon the expectation that such paper will, from time to time, come into its possession and become available to it as security or offset. So any business paper—paper that is or may be the basis of credit—is and logically should be subject to the lien. . . . When duly deposited with a banker as security or for collection, nothing more appearing, they are subject to his lien for the general balance due him. The exception is sustained."

Farr-Barnes Lumber Co. v. Town of St. George, 128 S. C. 67, 122 S. E. 24 (1924), was an action by the assignee of a promissory note executed by the defendant. The note had been assigned to the plaintiff by the Bank of St. George. The defense attempted to be set up was that the plaintiff was not a holder in due course, and this in turn was dependent upon the legal rights of the Bank of St. George in and to the note after its delivery by the original payee to the bank. The facts showed that one Traxler was indebted to the bank upon certain notes which had been discounted by the bank. The note in suit was delivered by him to the bank for collection. It was asserted by the bank that it was also an additional security for the indebtedness of Traxler to the bank. While the decision of the Court is based partly upon the assertion that the note was delivered to the bank as additional security, which, of course, would have been a specific pledge, the Court considered the rights of the parties also from the standpoint of a banker's lien against paper deposited

with the bank for collection and, in statement of the rule, quoted from 7 C. J. 613 as follows:

> "Where one who deposits paper with a bank for collection is indebted to the bank, the bank has a lien on the paper and the proceeds thereof for the amount of such indebtedness."

Another case in which a customer was indebted to the bank at the time of the deposit of the note for collection and no credit was extended is *Citizens Bank & Trust Co. v. Yantis* (Tex. Civ. App.), 287 S. W. 505 (1926). The Court said:

> "We think it is clear from the authorities that, when a note or other security is placed in a bank by its customer for collection or for general account, in respect to mutual dealings as such, the bank has a lien upon a note or its proceeds to secure the payment of past-due indebtedness."

The Court cited numerous cases in support of its conclusion, including *Bank of the Metropolis v. New England Bank, supra,* and *Joyce v. Auten,* 179 U. S. 591, 45 L. Ed. 332, and in explanation of the theory of the banker's lien stated:

> "Since the lien is given upon the theory that any credit the bank extends to its customer by way of loan or overdraft is given on the faith that money or securities sufficient to meet the debt at its maturity will come into the possession of the bank to discharge the same, of course, in such a case no express agreement is necessary. If there be an express agreement, then such securities would stand as collateral, but, in the absence of an express agreement, as seen, the relationship and mutual dealings do necessarily raise the implication of an agreement that the customer intends for his indebtedness to be liquidated with the

fund deposited, and the commercial paper deposited is to be collected and credited to his general account.

"*We know of no contrary holding* by our Supreme Court to the effect *that credit must be extended at time of deposit of paper,* and not otherwise, and, even though that be the law, which we deny, then as a matter of fact the extensions were granted after the Cooper note was received, and while the proceeds were being collected and applied."

The most recent decision upon this exact point is *Wells Fargo Bank & Union Trust Co. v. McDuffie,* 71 F. 2d 720, (C. C. A. 9, 1934). The facts in that case were complicated, but a careful analysis of them will show that acceptances were deposited for *collection only* after an indebtedness was existing. This Court said:

"*No credit had been extended on account of them,* but the bank had a lien thereon for all sums due it . . ."

A comprehensive discussion of the entire subject of banker's liens is found in 1 Jones on Liens, Third Edition, page 250. The author there states, at page 253, in reference to the case of *Davis v. Bowsher, supra:*

"And so if the securities be deposited after the credit was given, the banker has a lien for his general balance of account, unless there be an express contract or circumstances that show an implied contract inconsistent with such lien."

See also for a general discussion the notes to *Garrison v. Union Trust Co.,* 139 Mich. 392, 102 N. W. 978 (1905), in 111 Am. St. Rep. 407-419.

We therefore have a continuous, unbroken line of cases from the Common Bench of England in 1794 to this Court in 1934, *all* to the effect that a banker's lien attaches to collection items deposited with a bank as security for indebtedness owing to the bank, *without any extension of credit* at the time of deposit of the items. Appellant has not cited *one case* to the contrary. It may be safely assumed that there *are* no cases to the contrary because this principle is the very essence of the doctrine of the banker's lien as it existed under the law merchant and as it exists today.

The limitations upon the basic principle of the banker's lien are likewise stated in Lord Kenyon's opinion in *Davis v. Bowsher*. He says that the lien applies unless the banker received a particular security under special circumstances which would take it out of the general rule. This limitation is more broadly stated by the Supreme Court of the United States in *Reynes v. Dumont,* 130 U. S. 354, 32 L. Ed. 934-944 (1889), where the Court quotes from Kent's Commentaries as follows:

> ". . . yet a general lien does arise in favor of a bank or banker out of contract expressed, or implied from the usage of the business, in the absence of anything to show a contrary intention. It does not arise upon securities accidentally in the possession of the bank, or not in its possession in the course of its business as such, nor where the securities are in its hands under circumstances, or where there is a particular mode of dealing, inconsistent with such general lien."

Let us consider some of the cases discussing these limitations.

(b) The Securities Must Come Into the Hands of the Banker in the Course of Business as a Banker.

Section 3054 of the Civil Code provides that the lien attaches to property of the customer coming into the hands of the banker "in the course of the business." This clause can only mean in the course of the *banking* business. As such it is expressive of a limitation upon the application of the banker's lien universally recognized by the decisions.

One of the earliest cases illustrative of this point is *Brandao v. Barnett* (1846), 3 C. B. 519, 136 English Reports 207, cited by the California Code Commissioners and relied upon by appellant. We think that appellant's assertion that the lien in that case was held not to arise when certain exchequer bills were placed in the hands of the bank *because* there had been no credit advanced upon them and no facts analogous to an implied pledge (App. Op. Br., p. 27) is clearly not justified by the decision. The case stands for no more than the qualification imposed upon every statement of the scope of the banker's lien, *i. e.*, the lien attaches unless the security was delivered under special circumstances indicating that the lien was not to attach.

In this case one Burn held exchequer bills belonging to Brandao. He kept them in a locked box *to which he held the key* at the banking house of the defendants. Whenever it became necessary to receive the interest on the exchequer bills or to exchange them for new ones, Burn took them out of the box and gave them to the bankers for that purpose. When the interest or new bills were received they were returned to Burn and locked up in the box by him. The bills were never entered in Burn's account, but the bank had no knowledge that they did not belong to him. In the latter part of 1836 Burn removed the bills from the

box and gave them to the bankers to secure new ones, but by reason of illness he did not pick them up from the bankers before he suspended in January, 1937, at which time he was considerably overdrawn at his bankers. Brandao, the owner of the exchequer bills, sued to recover them and the bankers claimed a banker's lien. The opinion of Lord Campbell said:

> "Bankers most undoubtedly have a general lien on all securities deposited with them, *as bankers,* by a customer, unless there is an express contract, or circumstances that shew an implied contract, inconsistent with lien."

He quoted from Lord Kenyon in *Davis v. Bowsher (supra)* to the effect that "Bankers have a general lien on all securities in their hands for their general balance, unless there be evidence to show that any particular security was received under special circumstances which would take it out of the common rule," and then concluded that in the present case there was an implied agreement inconsistent with such claim of lien. He said:

> "Your lordships will bear in your recollections that the exchequer bills for which this action is brought are the new exchequer bills, which the defendants obtained for the express and only purpose of being delivered by them to Burn, that he might deposit them in the tin box of which he kept the key. They not only were not entered in any account between Burn and the defendants but they were not to remain in the possession of the defendants; and the defendants, in respect of them, were employed merely to carry and hold them till the deposit in the tin box could be conveniently accomplished."

It was clear that the Court considered that the exchequer bills were never delivered to the bankers in the ordinary course of the banking business. The Court said:

> "Bankers have a lien on all securities deposited with them as bankers; but *these exchequer bills cannot be considered as deposited with the defendants as bankers.*
>
> "During the argument in the Exchequer Chamber, it was very properly admitted by Sir Fitzroy Kelly (6 M. & G. 652, 7 Scott, N. R. 321) that 'if bills of exchange were delivered to a banker merely for the purpose of being deposited in a box, there would be no lien.' Does it signify whether the defendants were to deposit the securities in the box themselves, or were to deliver them for that purpose to Burn? I think, that under such circumstances, bankers acquire no lien, either upon the bills to be exchanged or upon the bills received in exchange."

This case effectively disposes of the fears expressed in the Petition for Rehearing that the banker's lien might be asserted against property in safekeeping or in a safe deposit box or handled through an escrow. Such incidental services are not the business of banking and the banker's lien could not apply.[3]

A modern illustration of the principal of *Brandao v. Barnett* is the case of *Powell v. Bank of America,* 53 Cal. App. 2d 458, 128 P. 2d 123 (1942), in which the banker's lien was denied. The facts of that case show that in its essence the transaction was an escrow transaction and therefore not one in the course of the banking business.

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[3]The acceptance of money or its equivalent in escrow is by statute not part of the banking business. Deering's General Laws, Act 652, §2.

Similarly in the case of *Della v. The Home Bank of Porterville,* 105 Cal. App. 106 (1930), the Court held that the money was received by the bank as a trustee for creditors and an offset or banker's lien would not apply.

(c) The Securities Must Belong to the Customer.

One element of the banker's lien expressed in the decisions and embodied in Section 3054 is that the securities upon which the lien is effective must belong to the customer.

It will be noted that in *Davis v. Bowsher,* Lord Kenyon referred to a lien upon securities *belonging* to any particular customer for *his* general balance. The Code section similarly provides for the lien upon property "belonging to a customer." This limitation was discussed in the other three cases cited by the Code Commissioners. The first of these was *Bank of the Metropolis v. New England Bank,* 1 How, 234, 11 L. Ed. 115; 6 How. 212, 12 L. Ed. 409.

In his opening brief, appellant relied strongly upon this case in support of his assertion that there could be no banker's lien unless there was an advance of credit upon the notes and drafts which were in the bank's possession. (App. Op. Br., pp. 28, 42.) In appellee's reply brief (p. 13) it was pointed out that this case and other cases referred to involved the question of a banker's lien upon collection items between corresponding banks, and that one principal reason for the absence of a banker's lien in those cases was that the forwarding bank held the item for collection merely and consequently had no title. In appellant's reply brief (p. 3) it is asserted that this contention is in error and that the Supreme Court of the United States in *Bank of Metropolis v. New England Bank* expressly refused so to hold. As this case is one of

cornerstones of appellant's contentions, we think that it should be considered more carefully.

There were three banks involved. The Bank of the Metropolis (Metropolis) located in the District of Columbia had a correspondent relationship with the Commonwealth Bank, Boston, Massachusetts (Commonwealth). The third bank was the New England Bank, Boston, Massachusetts (New England). New England, the plaintiff in the action, in the latter part of 1837 had deposited notes, drafts and other commercial paper with Commonwealth for collection. The paper fell due at various dates in the months of February to June, 1938, and was transmitted in the usual way to its correspondent, Metropolis, for collection.

On January 13, 1938, Commonwealth failed. *At that time* Metropolis held in its hands, for collection, the paper that belonged to New England but had been forwarded to it, properly indorsed, by Commonwealth. There was also an amount due from Commonwealth to Metropolis upon a current account between them. New England brought suit against Metropolis to recover the paper belonging to it.

The general course of dealing between the corresponding banks was stated by the Supreme Court as follows:

> "It appears from the evidence offered by the plaintiff in error, that for several years prior to the insolvency of the Commonwealth Bank (which happened in January, 1838), there had been mutual and extensive dealings between the two last mentioned banks, and an account current between them, in which they mutually credited each other with the proceeds of all paper remitted for collection when received, and charged all costs of protest, postage, etc. Accounts were regularly transmitted from the one to the other,

and settled upon these principles; and upon the face of the paper transmitted, it always appeared to be the property of the respective banks, and to be remitted by each of them on its own account.

"The balances in the account current fluctuated according to the amount of paper they respectively transmitted, and these balances it would seem were generally suffered to remain until they were reduced by the proceeds of the notes and bills deposited with each other in the usual course of their business."

We call the Court's attention to the manner in which credit was given—"they mutually credited each other with the proceeds of all paper remitted for collection *when received.*" It is difficult to distinguish that language from the stipulated fact here—"Claimant did, in the usual course of business, credit to the deposit account of the debtor, as and *when received,* the proceeds of all collection items" [R. 76]. It is clear that in each case the proceeds of the collections were *credited when received.* It should be noted further that the paper in issue all bore maturities later than the date of failure of Commonwealth, and therefore *no credit had been given by Metropolis.* The general course of dealing was *to give credit when the proceeds were received* exactly as the Bank gave credit to Salsbury when the items were collected.

At the trial the defendant Metropolis requested an instruction to the jury to the general effect that under the course of dealing described above, the defendant had the right to receive the paper *and the proceeds when recovered* until the balance of Commonwealth to Metropolis was paid. This instruction was refused and judgment rendered for New England.

From this statement of the facts, it is clear that the real issue in the case was the right of Metropolis to hold paper belonging to New England to secure a debt due from Commonwealth. But the Court considered first the legal principles applicable between the corresponding banks themselves. In that respect the facts were identical with the present case. Commonwealth (the debtor here) was indebted to Metropolis (appellee) for a general balance due. Commonwealth (the debtor) forwarded commercial paper to Metropolis (appellee) for collection and credit of the proceeds when received. Metropolis asserted the right to retain such paper against the general balance due from Commonwealth.

The Supreme Court said (1 How. [42 U. S.] 238-239):

> "If the notes remitted had been the property of the Commonwealth Bank, there would be no doubt of the right to retain; because it has been long settled, that wherever a banker has advanced money to another, he has a lien on all the paper securities which are in his hands for the amount of his general balance, unless such securities were delivered to him under a particular agreement."

There is no statement here that the banker must have advanced credit on the particular securities upon which he claims a lien. The facts show the contrary. There was no money advanced or credit given to Commonwealth upon receipt of the collection item by Metropolis. Credit was given when the proceeds were collected, not before. Commonwealth was already indebted to Metropolis upon the open account. The question was whether Metropolis was entitled to hold the items so received against the general balance. The Court said that as between the banks *there*

would be no doubt of the right of Metropolis to retain the items.

The paper was not owned by Commonwealth but by New England, which was seeking its recovery. The Court said that possession of the paper by Commonwealth was *prima facie* evidence of its ownership, and that without notice to the contrary Metropolis was entitled to treat it as such. The Court did not say that an extension of credit upon the particular items was essential to the validity of the lien. It said that *if* an advance of money had been made to Commonwealth upon this paper, the right to retain for that amount *would hardly be disputed,* but that *without* any advance the lien would exist if a balance in the general account was predicated upon the mutual dealings. The Court's language is (1 How. [42 U. S.] 239):

> "* * * and if an advance of money had been made upon this paper to the Commonwealth Bank, the right to retain for that amount would hardly be disputed.
>
> "We do not perceive any difference in principle between an advance of money and a balance suffered to remain upon the faith of these mutual dealings. In the one case as well as the other, credit is given upon the paper deposited or expected to be transmitted in the usual course of the transactions between the parties."

Upon the first appeal in this case, the judgment of the Court below was reversed because requested instructions upon this point had not been given to the jury.

The case was tried again and a second appeal taken to the Supreme Court (6 How. [47 U. S.] 212, 12 L. Ed. 409). The Court was of the opinion that the instructions

given to the jury on the second trial were not in conformity with the principles expressed in the Court's previous opinion and remanded the case for further trial. To assist the trial Court in submitting the matter to the jury, the Supreme Court itself stated the principles which should be embodied in the instructions to the jury in order to conform to the Court's prior opinion.

These principles were (6 How. [47 U. S.] 212, 12 L. Ed. 415):

1. If Metropolis had notice that Commonwealth was not the owner of the paper forwarded for collection it was not entitled to retain it as against New England.[4]

2. If Metropolis had no notice, but treated Commonwealth as the owner, it was nevertheless not entitled to retain the paper as against New England, the real owner, unless credit was given to Commonwealth or balance suffered to remain in its hands.

3. If Metropolis treated Commonwealth as the owner, without notice to the contrary, and upon the credit of remittances made or anticipated in the usual course of dealing suffered balances to remain in the hands of Commonwealth, it was entitled to retain the paper as against New England.

It is respectfully suggested that this case does not stand for the proposition urged by appellant that credit must be advanced upon the particular items before a banker's general lien can attach. On the contrary, in so far as it

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[4]This is in keeping with the provision of Civil Code, Sec. 3054, which limits the right of the banker's lien to *"property belonging to a customer."*

is a statement of the law merchant, it establishes two propositions:

First, as between a bank and its customer, the bank is entitled to retain an item delivered to the bank for collection, as against a general balance due, *without any extension of credit* upon the item. The Court says that wherever a banker has advanced money to another, he has a lien on all the paper securities which are in his hands for the amount of his general balance. It does not impose the qualification that credit must be advanced upon the particular item. The language of Section 3054 is practically identical. It says the banker has a general lien upon all property in his hands for the balance due in the course of business. Again there is no requirement that credit be extended upon the particular item upon which the lien is to attach.

Second, the bank is entitled to a general lien upon an item, *enforceable against the real owner,* if it has either (a) given credit to the forwarding bank or (b) suffered balances due from the forwarding bank to remain unpaid upon the expectation that future collection items will be transmitted.

Even if the present case were to be decided upon the basis of the second proposition of the *Metropolis* case, the applicability of the lien to property of *third persons*, the lien asserted by appellee would be valid because the evidence shows that appellee suffered balances to remain unpaid from Salsbury upon the expectation that future collection items would be deposited.

The cases of *Van Amee v. Bank of Troy* (1850), 8 Barb. 312, and *McBride v. Farmers Bank of Salem* (1857), 25 Barb. 657, both decisions of the Court of Ap-

peals of New York, which are relied upon by appellant (App. Op. Br. pp. 29, 30), were also cited by the California Code Commissioners.

In each of those cases, the issue involved was whether the banker's lien was enforceable against commercial paper deposited by the plaintiff in each action with Canal Bank for collection. The paper had been forwarded by Canal Bank to its correspondent for collection. At the time of failure of the Canal Bank it was indebted to each of the correspondent banks and they each sought to retain the paper under an asserted banker's lien. In each case, the lien was denied entirely upon the ground that the Canal Bank *was not the owner of the paper* and this fact was known or should have been known to its correspondent.

In each of the cases the New York Court referred to the holding of the United States Supreme Court in *Metropolis v. New England Bank (supra)* and particularly to that portion of the opinion which indicated that suffering balances to remain upon the expectation that future collection items would be forwarded was sufficient consideration to permit the banker's lien to attach *as against a third person* who owned the paper. In *Van Amee v. Bank of Troy (supra)* the Court said of its conclusion in this respect that "perhaps it would be different in cases coming before the Supreme Court of the United States." In the later case of *McBride v. Farmers Bank of Salem (supra)*, the Court said bluntly of that portion of the decision, "in this we do not concur with that learned Court."

What is the effect of these decisions on the interpretation to be placed upon Section 3054? The cases stand for nothing more than that the banker's lien cannot apply to securities in the hands of a bank *which do not belong to its customer* against whom the lien is asserted. They differ

in the ultimate result from *Bank of Metropolis v. New England Bank* because they do not agree with the Supreme Court in its conclusion that the banker might retain even the property of a third person if he had no notice of that title and either extended credit or suffered balances to remain on the faith of future transactions in the course of business.

The principle of the *Metropolis* case was followed in *Garrison v. Union Trust Company,* 139 Mich. 392, 102 N. W. 978, 111 Am. St. Rep. 407 (1905). There the collecting bank credited the account of the forwarding bank upon the day the latter bank failed. When the receiver of the failed bank repaid all deposits made upon the day of failure, the collecting bank sued to recover the amount of the credit resulting from the collection, predicated upon its banker's lien upon the collection item. The Court allowed recovery. It is interesting to note that the Court pointed out that the doctrine of the *Metropolis* case had been adopted and applied in the federal Courts and in the states of Michigan, Colorado, Indiana, Missouri and West Virginia but had been repudiated in New York and some other states. The Court indicated that in its view, the doctrine of the Supreme Court in the *Metropolis* case "is the better one, both upon reason and authority."

In *Russell v. Hadduck* (1846), 8 Ill. 232, one Gracie drew a bill on Russell payable to Smith & Co., N. Y., which was accepted by Russell. The bill was indorsed by Smith & Co. and sent to Newberry & Burch of Chicago for collection. Smith & Co. and Newberry & Burch were both bankers and brokers. The two firms were correspondents of and depositaries for each other; and when money was collected by one for the other, it was entered in the cash account as a credit. Before maturity of the bill,

Smith & Co. failed and Newberry & Burch sold the bill to Hadduck, who brought action against the acceptor, Russell. Judgment for plaintiff.

The Court, by Caton J., said:

> "I shall assume for the present that the case shows that the bill was in fact drawn merely for the purpose of collecting the amount of Russell, and that Smith & Co. *never paid Gracie anything for it,* and *that Newberry & Burch gave Smith & Co. nothing for it.* At the time of the failure of Smith & Co., the balance was against them and in favor of Newberry & Burch [for] more than the amount of this bill."

The controlling issue in the case was whether Hadduck was a *bona fide* purchaser of the bill as against Gracie, the drawer, who asserted ownership, and Russell, the acceptor. The Court concluded that he was. The Court said further:

> "It seems to me, also, that this case is very analogous to, if not precisely identical with the case of The Bank of the Metropolis v. The New England Bank, 1 How. 234."

After reviewing the facts and the Court's conclusion in the *Metropolis* case, the Justice made the statement appearing in this Court's former opinion and relied upon by appellant (App. Op. Br., p. 32), namely:

> "Here, then, is the true principle upon which this, as well as all other banker's liens must be sustained, if at all. There must be a credit given upon the credit of the securities, either in possession or *in expectancy.*"

We need go no further than this decision to learn what the Court had in mind by the words "in expectancy" and

demonstrate that the decision conforms to the *Metropolis* case. Quoting further from the opinion:

> "Counsel suppose they can see a difference between that case and this, because Willard, a clerk of Newberry & Burch, swore that they had kept funds in the hands of J. H. Smith & Co. to draw against. Whether funds were kept in their hands by remitting money directly, by accepting their drafts, or by transmitting paper for them to collect alone does not appear. It is most probable that it was done in the two latter modes at least, as is most usual with all bankers and brokers, nor does it seem to me to make any difference in principle. If they placed funds in the hands of Smith & Co. in either of these modes, it was upon the faith of the securities already on hand, *with the expectation that they would continue to remit paper for collection as formerly,* as well as upon the expectation that their draft would be honored."

The Court upheld the banker's lien (by upholding the title of the purchaser from the bank) when no advance of credit had been made on the item to anyone involved. No advance was made to Gracie, the owner, when he deposited it with Smith & Co. for collection, and no credit was given to Smith & Co. when they deposited it with Newberry & Burch for collection. Nevertheless, Newberry & Burch gave a valid title when they sold the note under their general banker's lien.

As we pointed out in Appellee's Brief (p. 13) these cases involving the right to a banker's lien as against the property of *third persons* are not controlling upon the issues here because here the lien is asserted upon property *belonging to the bank's customer.* However, the *Metropolis* case affirms the principle of *Davis v. Bowsher* because it holds that between the bank and its customer, the banker's

lien attaches to paper deposited for collection and credit when the proceeds are received *without any immediate credit when the paper is deposited.*

(d) Property Pledged for a Specific Indebtedness Cannot Be Held Under a Banker's Lien for Other Indebtedness.

As we have previously pointed out, the basic principle of the banker's lien does not permit a general lien where the securities come into the hands of the banker under special circumstances which would take it out of the general rule. One of the instances of special circumstances preventing the application of the banker's lien to particular securities arises in the case in which property has been specifically pledged for a particular debt. The cases hold that in such circumstances the specific pledge prevents the banker from holding the property under a general banker's lien for other indebtedness.

One of the earliest American authorities upon this point is the case of *Reynes v. Dumont,* 130 U. S. 354, 32 L. Ed. 934 (1889). In that case the issue before the Supreme Court was whether certain bonds which had been placed in the custody of a bank in New York by a New Orleans bank could be held under a banker's lien to secure an indebtedness of the New Orleans bank. Both banks had failed. The bonds originally had been left for safekeeping. Later they were specifically pledged to secure the remittance of exchange created by drafts drawn against shipments purchased by the New Orleans bank to the extent of $100,000. At the time of its failure, the New Orleans bank was not indebted for exchange purchased but was otherwise liable to the New York bank. The

question before the Court and the answer to it was stated by the Court as follows (32 L. Ed. 944):

> "But if the bonds were liable by express contract for the obligations of the bank, could they also be made to respond to the indebtedness of Cavaroc & Son, in the absence of express agreement, by force of a lien implied from the usage of the business?
>
> "In our judgment, the bonds, being in effect all pledged to guarantee the remittance by the bank of exchange purchased, could not be held by implication as security for the indebtedness of Cavaroc & Son on a balance of account. The specific pledge withdrew them from the operation of the alleged bankers' lien, for it was inconsistent with the presumed intention of the parties."

In support of its conclusion the Court referred to numerous cases (among them *Brandao v. Barnett,* 3 C. B. 518, 136 English Reports 207, relied upon by appellant), all to the general effect that a banker's lien cannot attach for a balance due on a general account *where the property has been pledged for a specific obligation.* It quoted from its prior opinion in *National Bank v. Insurance Co.,* 104 U. S. 54, 71, to the effect that the banker's lien attaches unless modified or waived by some agreement, express or implied, or by conduct inconsistent with its assertion.

Reynes v. Dumont has been followed in California. In *Bell v. Bank of California,* 153 Cal. 234, the California Supreme Court said that "where property is pledged to secure specific indebtedness, the pledgee has no right to hold it for any other obligation," citing *Reynes v. Dumont.* The same ruling was made in *Berry v. Bank of Bakersfield,* 177 Cal. 206. In that case the Court cited *Bell v.*

Bank of California and, among other decisions, *Masonic Savings Bank v. Bangs, Adm.*, 84 Ky. 135, 4 Am. St. Rep. 197, which was one of the cases relied upon by the Court in *Reynes v. Dumont.*

This principle and the holdings in *Berry v. Bank of Bakersfield* and *Bell v. Bank of California* have been recognized by this Court. In *Wells Fargo Bank & Union Trust Co. v. McDuffie*, 71 F. 2d 720, 726, this Court said:

> "But such an express agreement was necessary for under the law of California where specific property is pledged for a specific obligation to a bank, the bank has no general banker's lien upon the proceeds of the pledged property. . . . Arnold v. San Ramon Valley Bank, 184 Cal. 632, 194 P. 1012, 13 A. L. R. 320; Bell v. Bank of Cal., 153 Cal. 234, 94 P. 889; Berry v. Bank of Bakersfield, 177 Cal. 206, 170 P. 415; Continental Nat'l Bk. v. Moore, 299 F. 270 (C. C. A. 9)."

Another case which comes in this category is *In re Cummins Construction Corporation* (1947 D. C. Md.), 72 Fed. Supp. 409. This case is cited in Appellant's Opening Brief (p. 39) as authority for the proposition that a bank does not have a lien where it has bare custody of the item. The facts were that the proceeds of certain government contracts had been assigned to the bank to secure loans in connection therewith. The loans were paid, but before the assignment was cancelled an additional government check was received by the bank and it attempted to apply the proceeds of the check to the payment of other indebtedness. The Court held that the attempted retention of the money constituted a preference because the debt for which the moneys were assigned had been paid. It would appear that the case was more one of offset than

banker's lien, but in any event the principle applied was that of *Reynes v. Dumont (supra)* that property pledged for a specific debt cannot be held for some other debt under a general banker's lien.

These cases have no bearing upon the issues here nor upon the proposition urged by appellant that immediate credit must be granted for the banker's lien to attach. They demonstrate the qualification imposed by the Supreme Court in *Bank of the Metropolis v. New England Bank (supra)* when it said the banker has a lien "unless such securities were delivered to him under a particular agreement." In the present case there was no pledge, and neither *Reynes v. Dumont* nor *Bell v. Bank of California* nor *Berry v. Bank of Bakersfield* is applicable.

(e) There Is No Lien When Circumstances Indicate a Lien Was Not Intended.

There are circumstances other than those which have been classified in the preceding subdivisions in which the courts have applied the limitation expressed in *Davis v. Bowsher* that the lien attaches "unless there be evidence to show that he received any particular security under special circumstances, which would take it out of the common rule."

The case of *Hanover National Bank v. Suddath* (1909), 215 U. S. 110, 54 L. Ed. 115, relied upon by appellant (App. Op. Br. p. 36) is an illustration of such circumstances. The American National Bank of Abilene, Texas, was indebted to the Hanover National Bank upon an open account. It sent a promissory note to the Hanover Bank with a letter stating it was sent for discount and credit, that is, the Hanover bank was to buy the note and give the Abilene bank credit for it. It was *not* sent for collec-

tion, as stated by appellant, but for discount. The Hanover bank, upon receiving the note, replied stating that it was not acceptable for discount but was being held as collateral for the indebtedness owing.

In an action by the receiver of the Abilene bank to recover the note, the Hanover bank claimed the right to hold it under its general banker's lien. Upon this point the Supreme Court said (215 U. S. 116, 54 L. Ed. 118):

> "The rulings of this court foreclose this question, since they conclusively establish that a general lien in favor of a bank cannot attach to securities which are delivered to it in order that it may do a particular thing with them, and that, when it refuses to do that thing, the duty to return exists. The general subject was elaborately considered, and the authorities were fully reviewed, in Reynes v. Dumont, 130 U. S. 354, 32 L. ed. 934, 9 Sup. Ct. Rep. 486."

Here again, the absence of the banker's lien was not due to the fact that no credit had been extended. It was held that there was no lien because the lien was inconsistent with the intention of the parties. The note had been delivered for a particular purpose and could not be used for any other purpose.

The same situation existed in *Bank of Montreal v. White* (1880), 13 Otto [103 U. S.] 71; 26 L. Ed. 307,[5] cited by the Court in *Hanover National Bank v. Suddath (supra)* and relied upon by appellant. The note was sent to the bank for *discount* and credit of the proceeds and not as a collection item in the usual course of business. The

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[5]The case is erroneously cited in the *Hanover* case and in appellant's brief as 154 U. S. 660. The opinion appears as above cited.

bank declined to discount the note and the Court said there was nothing in the facts to indicate that if the bank declined to purchase the note it could keep it as collateral.

The case of *Biebinger v. Continental Bank* (1878), 99 U. S. 143, 25 L. Ed. 271, did not in fact involve a banker's lien at all, although it is sometimes cited to that effect. *The action was one to establish an equitable lien on real estate.* The Supreme Court said:

> "There are no allegations in the bill which would bring the case within the principle of an *equitable mortgage* by deposit of title deeds. . . . There is no allegation of money loaned or debt created on the faith of the deposit of this deed."

A banker's lien is in every case dependent on the banker's having the property in his hands. The bank did not have possession of the real estate. *It was not asserting a banker's lien on the deed.* It was seeking to establish an equitable lien on the real estate. Entirely different principles are applicable and the case cannot be considered as authority for the contention that credit must be extended upon a particular collection item before a banker's lien can attach.

A few other miscellaneous cases have been cited by appellant as purported authority for his basic contentions, and brief reference to them will be made.

Appellant states (App. Op. Br. p. 25): "The banker's lien apparently originated from the practice wherein banks discounted bills of exchange for merchants and thereby extended credit on the bills. Either the banks owned these bills or they were protected by a banker's lien for the advances made on the bills. Early English cases so indicate." As authority for this proposition appellant cites

the cases of *Giles v. Perkins* (1807), 7 East 11, 103 Eng. Rep. 477, and *Thompson v. Giles* (1824), 2 B. & C. 422, 107 Eng. Rep. 441. In each of these cases bills not due had been deposited with bankers for collection, although credit apparently had been extended upon them. In each case the *banker* became bankrupt, and at the time of bankruptcy balances existed in *favor* of the plaintiffs. The issue in each case was whether the trustee in bankruptcy of the *bankers* could retain the bills upon the theory that they had been discounted. The Court in both cases held that the transactions did not amount to a discount and the trustees in bankruptcy were not entitled to retain the items. There was no question of a banker's lien because there was no indebtedness owing to the bank.

Cases concerned with the right of offset have likewise been cited in support of appellant's position. One such case was *Central National Bank v. Connecticut Mutual Life Insurance Co.* (sometimes cited as National Bank v. Insurance Co.), 104 U. S. 54, 71, 26 L. Ed. 693, 701 (1881). The real issue in that case was the right of the bank to exercise an offset against a deposit account. The Court ruled that the deposits were trust funds and that the bank knew or should have known that fact. It denied the right of offset. There is no indication from reports of the case that a banker's lien was asserted and the Court's language with respect to it was by way of explanation of the asserted right of offset.

In *Niblack v. Park National Bank* (1897), 169 Ill. 517, the question involved was that of the right to offset a deposit account against a note held by the bank. Under

the law of Illinois at the time, a check drawn upon a bank operated as an assignment of the funds on deposit. After a check had been presented, the bank attempted to exercise an offset. The Court held that a banker's lien could not apply to funds on deposit, and its reference to the nature of a banker's lien by a quotation from the case of *Fourth National Bank v. National City Bank,* 68 Ill. 398, which in turn quoted from *Russell v. Hadduck (supra),* was only by way of illustration. *Moore v. Third National Bank* (1910), 41 Pa. Sup. Ct. 497, was likewise concerned only with the right of offset. Checks deposited upon the day of filing the bankruptcy petition could not be offset against an indebtedness of the bankrupt.

Appellant has asserted that the statement of the nature and scope of the banker's lien made by the California Supreme Court in *Gonsalves v. Bank of America* (1940), 16 Cal. 2d 169, was merely "a statement introductory to an explanation of the right of set-off." (App. Op. Br. p. 23.) That, of course, is correct. Nevertheless, *it is the considered expression of the Supreme Court of this state.* It is of far greater value in determining the law of this state today than a similar explanation by the courts of another jurisdiction.

Anglo-California Bank v. Grangers Bank (1883), 63 Cal. 359, has no relation whatever to the facts here. The Court said there could be no banker's lien because the bank did not have possession of the shares of stock, but there were other obvious reasons why the assertion of a banker's lien was entirely without merit.

Summary.

The basic principle of the banker's lien, as stated in Section 3054 and exemplified by the decisions, is that wherever an individual is indebted to a bank, the bank has a lien upon all property which comes into its hands for the general balance due, unless the property comes into the bank's hands under special circumstances which would take it out of the general rule.

Special circumstances sufficient to take a case out of the general rule have been shown by the decisions to be in the following categories:

(i) Where the property does not come into the hands of the bank *as a banker,* thus the lien does not attach when the property is received for safekeeping, safe deposit, in escrow or trust;

(ii) Where the property does not belong to the customer, although here the lien will attach if the bank has extended credit upon it or suffered balances to remain unpaid upon the faith of a course of dealing;

(iii) Where the property is pledged for a specific debt it cannot be held for some other debt; and

(iv) Where the circumstances indicate the application of a lien would be contrary to the intention of the parties.

The handling of commercial paper, notes, drafts, acceptances, checks and similar instruments, whether by way of discount or for collection, has been historically the function of bankers. Commercial paper coming into the hands of a bank in the course of the banking business is subject to the banker's lien for a balance due on account, in the absence of such special circumstances, whether or not any credit has been extended upon it at the time it was deposited with the bank.

It is true that the banker's lien is an implied pledge—it is a pledge implied by law without the express contract of the parties. Appellant's argument is that if the bank intends to rely upon notes and drafts deposited with it for collection as collateral or security for an indebtedness, it should be so stated in the loan agreement and such items pledged with the bank. Such an argument, of course, ignores the existence of the statute. As we have seen, there can be no general banker's lien when specific property is pledged. Appellant is in effect arguing that there can be no lien unless it is pledged. The result would be to exclude the statute from any effectiveness whatever.

It is respectfully submitted that under the facts of this case appellee was entitled to a banker's lien upon the notes and drafts deposited with it for collection and in its hands at the time of filing the debtor's petition whether or not any credit was advanced to the debtor upon the deposit of such items.

It is respectfully suggested that this Court's prior opinion impliedly limits the right to a banker's lien to instances where the bank has extended credit or suffered balances to remain unpaid in reliance upon a course of dealing. Such an implication, we believe, arises from the fact that the Court refers to the Receiver's contention that the banker's lien does not attach to commercial paper delivered for collection unless and until the bank extends credit thereon, and this is followed by the Court's statement that there is no problem here as to whether the lien is impressed upon securities delivered to a bank under an instruction to collect and deposit the proceeds to the deliverer's account, without more, and that the Court, under these limited circumstances, need not decide whether the California statute would impose the lien.

Such an implication casts doubt upon the meaning of the California statute which, it is respectfully suggested, is not justified either by the language of the statute, the decisions of the California courts interpreting it, or the historic rule of the law merchant. The cases which have heretofore been cited in this brief show that wherever there is an indebtedness owing to a bank, the bank has a lien upon securities thereafter coming into its hands until the indebtedness is paid. The rule contains no requirement that new or additional consideration pass to the customer before such a lien attaches. Any decision of this Court casting a doubt upon such a firmly established principle would lead to endless litigation by bankruptcy trustees seeking to recover assets for bankrupt estates upon asserted causes of action which are clearly unjustified by the historic role of the banker's lien.

Upon the facts of this particular case, the evidence shows that there was a course of dealing between the parties under which the bank extended credit and suffered balances to remain outstanding in expectation that the banking business of the debtor, including specifically the deposit and collection of commercial paper, would be handled with the bank. If any consideration were required upon the deposit of the items in order for the banker's lien to attach, we have shown that under the authorities a suffering of balances to remain unpaid is sufficient to authorize the banker's lien to be asserted as against the property of third persons. As between the bank and its customer, however, the authorities show that no credit need be advanced to the customer at the time the property comes into the hands of the bank. It is respectfully suggested, therefore, that the implication contained in this Court's prior opinion will limit the scope of the banker's lien in a manner not justified by the decisions and the provisions of the statute.

POINT III.

Statutory Lien Is Not a Preference.

A considerable portion of the argument in the Petition for Rehearing is devoted to the assertion of the grave injury that will result to non-bank creditors of a debtor or bankrupt by permitting banks to exercise a banker's lien upon commercial paper that has been deposited for collection without an advance of funds to the bank's customer. It is asserted that creditors are generally mindful of the fact that deposits with a bank are subject to the right of set-off in the event of bankruptcy, but that no creditor would believe that notes and drafts in the hands of the bank for collection would be subject to a banker's lien. Appellant asserts further that under the Court's opinion the Court has permitted a new type of secret lien contrary to the express intention of the Bankruptcy Act.

The argument that the exercise of a banker's lien upon collection items creates a secret lien contrary to the intention of the Bankruptcy Act and contrary to the decisions of the Supreme Court of the United States is entirely unwarranted and unsupported by authority.

The banker's lien in this state, at least, is a statutory lien derived from Section 3054 of the Civil Code of the State of California. The Bankruptcy Act by its terms provides that liens provided for by statute in favor of various classes of persons created or recognized by the laws of any state are valid against the trustee even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the bankruptcy pro-

ceedings.[6] While the statute refers specifically to statutory liens in favor of employees, contractors, mechanics and landlords, it also refers to "other classes of persons," and clearly the statutory banker's lien provided for by the Civil Code brings bankers within the other classes of persons referred to by the section.

The argument that a lien authorized and provided for by statute is a secret lien is not sound. The statute providing for such a lien can only be enacted by the State Legislature and the public is presumed to know its provisions. The editorial comment of the authors of Collier on Bankruptcy (14th Ed.), Vol. 4, page 161, is instructive on this point. The authors say:

> "Some recognition of statutory liens in bankruptcy cannot on general principles be open to serious objection. The existence of such protective legislation on the statute books in any particular state is an unequivocal expression of the lawmakers' collective

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[6]Section 67b of the Bankruptcy Act (11 U. S. C. 107b) provides as follows:

> "The provisions of section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapter X, XI, XII, or XIII of this Act, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court."

judgment that the particular class of persons or the sovereign has a special interest in and claim upon the property of the debtor which deserves special treatment. Moreover the universality of many types of statutory liens is persuasive that unsecured creditors are not unduly prejudiced or unjustly treated when their rights in bankruptcy are subordinated to such liens."

In the case of *Henderson v. Mayer,* 225 U. S. 631, 637, 56 L. Ed. 1233, 1235 (1912), the Supreme Court was discussing the validity of a levy of distress for unpaid rent as against the rights of the trustee in bankruptcy of the tenant. The Court, speaking through Mr. Justice Lamar, said:

> "The provisions of the bankruptcy act, preventing an insolvent from giving or the creditor from securing preferences for pre-existing debts, apply not only to mortgages and transfers voluntarily made by the debtor, but also to those preferences which are obtained through legal proceedings, whether the lien dates from the entry of the judgment, from the attachment before judgment, or, as in some states, from the levy of execution after judgment. But the statute was not intended to lessen rights which already existed, nor to defeat those inchoate liens given by statute, of which all creditors were bound to take notice, and subject to which they are presumed to have contracted when they dealt with the insolvent."

The language of the District Judge for the Northern District of New York in *In re Caswell Construction Co., Inc ,* 13 F. 2d 667 (1926), is also enlightening upon this point. In considering whether or not a mechanic's lien as created by the laws of New York was within Section

67d of the Bankruptcy Act as it existed at that time, the Judge said:

> "Statutory liens and common-law liens, like those of lodging house keepers, are neither 'given' nor 'accepted' in good faith or otherwise. The only liens that can be given or accepted in good faith would seem to be voluntary liens. Statutory and common-law liens are not voluntary liens, but are exactly the opposite, namely, involuntary liens. They arise by operation of law, with or without some affirmative action on the part of the lienors, and without any participation on the part of the owner of the property. They are not given voluntarily, but they are imposed involuntarily upon the property of the owner, who may be called a lienee. There is authority for holding that statutory liens do not come under and are not included within the provisions of section 67d. *In re* Cramond (D. C.), 145 F. 966-976."

These cases were decided under the 1910 Amendment to the Bankruptcy Act of 1898, and under that statute there was considerable uncertainty as to whether statutory liens were valid as against a trustee in bankruptcy. The 1938 amendments to the Bankruptcy Act, however, removed any doubt upon this score. Section 67b provides specifically that liens created by statute shall be valid against a trustee in bankruptcy notwithstanding the provisions of Section 60a (see *Davis v. City of New York,* 119 F. 2d 559 (C. C. A. 2, 1941); *Commercial Credit Co., Inc. v. Davidson,* 112 F. 2d 54 (C. C. A. 5, 1940).) It is respectfully submitted that there is no merit to the argument that the banker's lien provided for by Section 3054 of the Civil Code, creates a preference or a secret lien contrary to the intention of the Bankruptcy Act.

Conclusion.

For the reasons and upon the authorities hereinabove set forth, it is respectfully submitted that this Court should determine that appellee was entitled to assert its banker's lien upon the collection items in its hands at the time of the filing of the debtor's petition and that the judgment of the Referee and the District Court should be affirmed.

Respectfully submitted,

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